

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Oller Analyst: Kristina E. North Bill Number: SB 155  
Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: January 31, 2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Prescription Drug Credit

### SUMMARY

This bill would allow a 100% credit to individuals over 55 years of age for the costs of prescription drugs that are not reimbursed or paid for by insurance.

### PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide financial relief to senior citizens for the cost of prescription medication that is not otherwise reimbursed or paid for through any federal, state, or other public or private health plan.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and would be operative for taxable years beginning on or after January 1, 2001.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Current federal and state laws specifically allow unreimbursed medical care expenses, including costs for prescription drugs or insulin, to be deducted for income tax purposes. The expenses may be deducted only to the extent that they exceed 7.5% of the taxpayer's adjusted gross income (AGI). The federal law defines "prescribed drug" as a drug or biological that requires a prescription of a physician for its use by an individual.

Current federal and state laws contain various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:

\_\_\_\_ S      \_\_\_\_ NA      \_\_\_\_ NP  
\_\_\_\_ SA      \_\_\_\_ O      \_\_\_\_ NAR  
\_\_\_\_ N      \_\_\_\_ OUA      \_\_\_\_ X PENDING

Department Director

Date

Gerald H. Goldberg

03/09/01

Neither current federal nor state law has a credit comparable to the prescription drug tax credit proposed by this bill.

### THIS BILL

**This bill** would allow a 100% credit to individuals over 55 years of age for prescription drug costs that are not reimbursed or paid for by public or private health insurance plans.

**This bill** would allow any excess credit to be carried over indefinitely until used.

### IMPLEMENTATION CONSIDERATIONS

- Definitions are needed for "prescription drugs," "not reimburseable or payable," and "public or private health insurance plans." The author may wish to consider using the federal income tax law definition of prescription drugs and a federal public health and welfare code definition for "health plan."
- This bill would allow a taxpayer to claim this credit for prescription drugs even if the drugs are purchased for a member of the taxpayer's family or for transfer or resale to another person. If the author intends that this credit should be claimed only on drugs purchased for the use of the individual who is over 55, the author may want to consider amending the bill accordingly.
- This bill would allow a taxpayer to claim both this credit and a deduction for the same expenses.
- This bill does not limit the number of years for the credit to be carried over. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits typically are exhausted within eight years of being earned.

Department staff is available to work with the author to resolve these and any other concerns.

### **LEGISLATIVE HISTORY**

**AB 2533 (Pacheco - 2000)** This bill would have allowed a credit equal to 25% of costs paid by a taxpayer for prescription drugs. The credit would have been limited to \$300 for an individual and \$600 for a married couple filing jointly. This bill failed to pass the Assembly Revenue and Taxation Committee.

### **OTHER STATES' INFORMATION**

*Michigan* currently has a refundable prescription drug credit for individuals 65 years of age or older whose household income does not exceed 150% of the federal poverty level. The individual may not be a resident in a health care or mental care facility licensed or operated by the state. The prescription drug must be purchased directly by the individual and the cost cannot be covered by a third party reimbursement plan. The credit is not reported on the individual's return as an offset against tax liability, but is claimed on a separate form prescribed by the revenue department.

Review of *Illinois*, *Massachusetts*, *Minnesota*, and *New York* laws found no comparable tax credits or deductions. However, both *Illinois* and *New York* are pursuing legislation in this area. These states were reviewed because of the similarities between California income tax laws and their tax laws.

## FISCAL IMPACT

This bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

Based on data and assumptions discussed below, this bill would result in revenue losses as follows.

Estimated Revenue Impact of SB 155 As Introduced 1/31/01 [\$ In Millions]		
2001/2002	2002/2003	2003/2004
-\$610	-\$640	-\$770

This analysis assumes the qualifying taxpayer also must be the user of the prescribed drugs, that is, the prescribed drugs are not acquired for transfer or resale to someone else. If a federal bill was enacted to provide a similar credit for prescription drugs, state revenue losses would increase roughly an additional 20% in the initial fiscal year due to greater taxpayer awareness.

## Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of unreimbursed costs incurred by qualified taxpayers for prescription drugs and the amount of credits that could be applied to reduce tax liabilities.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs by individuals age 65 and older was projected at \$675 for 2001. A simulation was performed using personal income tax sample data. As the proposed credit is for 100% of unreimbursed costs, the senior exemption credit was increased by \$675 as a proxy for the new credit. Assuming each qualified taxpayer in the sample generated the average credit, the simulation models the maximum revenue loss to the extent credits generated could be applied to reduce tax liabilities. The loss is increased an additional 25% to represent qualified taxpayers aged 55-64. This was based on the proportion of the population aged 55-64 relative to all those aged 55 and older and reflects that individuals aged 55-64 spend less on prescription drugs than those individuals over age 65.

Reduction adjustments were made to the model results to allow for (1) some small portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold), and (2) to reflect the rate at which qualified taxpayers would actually report the credit on their tax returns.

## ARGUMENTS/POLICY CONCERNS

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

This bill does not contain a sunset date. Credits are generally enacted with a sunset date to ensure periodic review by the Legislature.

**LEGISLATIVE STAFF CONTACT**

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